

Audit Report



INSPECTOR GENERAL, DOD, OVERSIGHT OF THE ARMY AUDIT
AGENCY AUDIT OF THE FY 1998 ARMY WORKING CAPITAL
FUND FINANCIAL STATEMENT AUDIT

Report Number 99-093

March 1, 1999

Office of the Inspector General
Department of Defense

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Acronyms

AAA	Army Audit Agency
IG	Inspector General



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

March 1, 1999

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Inspector General, DoD, Oversight of the Army Audit
Agency Audit of the FY 1998 Army Working Capital Fund Financial
Statements (Report No. 99-093).

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Army Audit Agency (AAA) disclaimer of opinion on the Army Working Capital Fund Financial Statements for FY 1998, along with the AAA Auditor Report, "Army Working Capital Fund Principal Financial Statements for Fiscal Year 1998." An audit of the Army Working Capital Fund Financial Statements is required by the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. Because this report contains no recommendations, comments are not required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird, (703) 604-9175 (DSN 664-9175) (rbird@dodig.osd.mil); or Mr. Jack Armstrong at (317) 510-3846 (DSN 699-3846) (jarmstrong@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 99-093

(Project No. 8FI-2027.01)

March 1, 1999

Inspector General, DoD, Oversight of the Army Audit Agency Audit of the FY 1998 Army Working Capital Fund Financial Statement Audit

Executive Summary

Introduction. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires an audit of the Army Financial Statements. We delegated to the Army Audit Agency the audit of the FY 1998 Army Working Capital Fund Financial Statements. This report provides our endorsement of the Army Audit Agency disclaimer of opinion on the Army Working Capital Fund Financial Statements for FY 1998, along with the “Army Working Capital Fund Principal Financial Statements for Fiscal Year 1998: Auditor’s Report.”

Audit Objective. The audit objective was to oversee the independent audit of the Army Working Capital Fund FY 1998 Financial Statements conducted by the Army Audit Agency. See Appendix A for a discussion of the audit process.

Audit Results. The “Army Working Capital Fund Principal Financial Statements for Fiscal Year 1998: Auditor’s Report,” March 1, 1999, stated that the Army Audit Agency was unable to express an opinion on the Army Financial Statements for FY 1998. We concur with the Army Audit Agency disclaimer of opinion; our endorsement of that disclaimer of opinion is Exhibit 1. The Army Audit Agency report is Exhibit 2.

Internal Control Structure and Compliance With Laws and Regulations. The Army Audit Agency issued reports on internal controls and compliance with laws and regulations in the Army. Those reports are included in the Army Audit Agency report.

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Appendix A. Audit Process

Scope and Methodology

Audit Work Performed. To fulfill our responsibilities under the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, we provided oversight of the independent audit conducted by the Army Audit Agency (AAA) of the FY 1998 Army Working Capital Fund Financial Statements. Our purpose was to determine whether we could rely on the AAA audit. We reviewed the AAA audit approach and planning, and monitored audit progress at key points.

Reviewing AAA Audit Approach and Planning. We used the President's Council on Integrity and Efficiency "Financial Statement Audit Manual" and the General Accounting Office "Financial Audit Manual" as the criteria for reviewing the AAA audit approach and planning. Specifically, we reviewed the engagement letter, entrance conference documentation, strategy formulation, audit plans, and audit programs. We reviewed additional documentation as deemed necessary to accomplish the audit objective. We also participated in audit planning conferences and workshops coordinated by AAA.

Monitoring Audit Progress at Key Points. Through the Inspector General (IG), DoD, Executive Steering Committee, we provided a forum for a centrally managed exchange of information and guidance leading to a focused DoD-wide audit of the DoD consolidated financial statements for major DoD components. Audit initiatives for monitoring the progress of the audit at key points include active participation in audit working groups focused on significant topics material to Army Working Capital Fund financial reporting, such as the Statement of Budgetary Resources, and Eliminating Entries audit working groups. Also, we reviewed and commented on related draft reports issued by AAA, including the audit opinion report and the report on the evaluation of internal controls and compliance with laws and regulations.

In addition to the oversight procedures, we performed other procedures deemed necessary to determine the fairness and accuracy of the AAA audit approach and conclusions. For example, we co-performed audit work with the AAA for verification of completeness on The Statement of Budgetary Resources, and Statement of Net Cost.

DoD-wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance Results Act, the Department of Defense has established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objectives and goals.

Objective: Fundamentally reengineer the Department and achieve a 21st century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. (DoD-6)

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objectives and goals.

Financial Management Area. Objective: Strengthen internal controls.
Goal: Improve compliance with the Federal Managers' Fiscal Integrity Act. (FM-5.3)

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Financial Management high-risk area.

Audit Period and Standards. We performed this financial statement audit from February 25, 1998, through March 1, 1999. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We did not use computer-processed data or statistical sampling procedures to conduct this audit.

Contacts During the Audit. We visited or contacted individuals and organizations in the DoD audit community. Further details are available on request.

Summary of Prior Coverage

The General Accounting Office and the IG, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed over the Internet at <http://www.gao.gov>. Inspector General reports can be accessed over the Internet at <http://www.dodig.osd.mil>.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Indianapolis Center
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations

Office of Management and Budget
General Accounting Office
National Security and International Affairs Division
Technical Information Center

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform

**Exhibit 1. Inspector General, DoD,
Endorsement Memorandum**



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

March 1, 1999

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 1998 Army
Working Capital Fund Financial Statements (Project No. 8FI-2027)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. We delegated to the Army Audit Agency (AAA) the audit of the FY 1998 Army Working Capital Fund Financial Statements. Summarized below are the AAA disclaimer of opinion on the FY 1998 Army Working Capital Fund Financial Statements and the results of our review of the AAA audit. We endorse the disclaimer of opinion expressed by the AAA (Enclosure).

Disclaimer of Opinion. The AAA disclaimer of opinion on the FY 1998 Army Working Capital Fund Financial Statements, dated March 1, 1999, states that the AAA was unable to express an opinion on the financial statements. We concur with the AAA disclaimer of opinion for the reasons summarized below.

The AAA concluded that the accounting systems used to account for the Army Working Capital Fund did not have complete general ledger controls and in some instances lacked adequate audit trails. The AAA could not verify:

- inventory adjustments made to the financial accounting records,
- inventory in transit from procurement,
- reported Government-furnished material,
- supply revenue reported on the Statement of Net Cost and the Statement of Changes in Net Position, and
- amounts reported on the Statement of Budgetary Resources and the Statement of Financing.

Internal Controls. The AAA determined that internal controls did not ensure that the FY 1998 Army Working Capital Fund Financial Statements contained no material misstatements. Inventory, logistical, and financial records were not reconciled, inventory receipts had not been recorded, financial records could not accurately reflect material consumed in the possession of contractors, and while some transactions lacked audit trails, other transactions lacked supporting documentation. Specifically, \$104 billion in accounting adjustments lacked adequate audit trails. The Army and the Defense Finance and Accounting Service have recognized many of the financial reporting weaknesses and reported them in their FY 1998 Annual Statements of Assurance. Details on internal controls will be discussed in a separate report.

Compliance With Laws and Regulations. The AAA also identified areas of noncompliance with laws and regulations, which will be discussed in more detail in a separate report. Under the Federal Financial Management Improvement Act of 1996

and OMB Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended January 25, 1999, the AAA work disclosed that financial management systems did not substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For example, financial management systems did not maintain audit trails and documentation requirements for journal entries, which is a Federal financial management system requirement. In addition, financial management systems did not selectively generate required transactions needed for year-end closing procedures as well as the rollover of general ledger account balances, as required by the Joint Financial Management Improvement Program Federal Financial Management System Requirements-1, "Core Financial System Requirements."

Review of Army Audit Agency Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent audit conducted by the AAA, we reviewed the audit approach and planning and monitored progress at key points. We also performed other procedures to determine the fairness and accuracy of the approach and conclusions.

We reviewed the AAA work on the FY 1998 Army Working Capital Fund Financial Statements from February 25, 1998, to March 1, 1999, in accordance with generally accepted Government auditing standards. We found no indication that we could not rely on the AAA disclaimer of opinion or its related evaluation of internal controls and compliance with laws and regulations.



David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosure *

* The Enclosure is included in Exhibit 2, pages 5-12.

Exhibit 2. Army Audit Agency Report

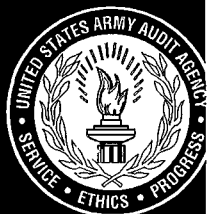
**Army Working Capital
Fund Principal Financial
Statements for
Fiscal Year 1998**

Auditor's Report

**19 February 1999
Audit Report: AA 99-160**



U.S. Army Audit Agency





DEPARTMENT OF THE ARMY
OFFICE OF THE AUDITOR GENERAL
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1596

19 February 1999

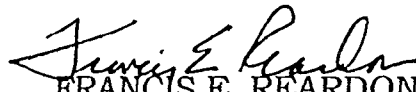
Secretary of the Army

This report summarizes the results of our efforts to audit the Army Working Capital Fund Financial Statements for fiscal year 1998. We performed our work pursuant to the Chief Financial Officers Act of 1990 (Public Law 101-576) as expanded by the Government Management Reform Act.

The Army Working Capital Fund lacks sound accounting systems that have complete audit trails and supporting documentation. These problems prevented the Army and the Defense Finance and Accounting Service from preparing useful financial statements and limited the scope of our review. For these reasons, we were unable to express an opinion on the financial statements. We were unable to apply other auditing procedures in these areas to satisfy ourselves as to the fairness of the financial information presented.

Brief discussions of our results and conclusions are in the Auditor's Report section of this report. We will present more detailed discussions in the supporting audit reports that we will publish separately.

I appreciate the courtesies and cooperation extended to us during the audit.


FRANCIS E. REARDON, CPA
The Auditor General

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AUDITOR'S REPORT



DEPARTMENT OF THE ARMY
OFFICE OF THE AUDITOR GENERAL
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1596

19 February 1999

Secretary of the Army

The Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994, requires the Army to prepare annual financial statements for the Army Working Capital Fund. The Inspector General, DOD is responsible for auditing financial statements within the Department of Defense. The Inspector General, DOD delegated the responsibility of auditing the Army Working Capital Fund financial statements to us.

The Army has accounting system deficiencies, incomplete audit trails, and weaknesses in its internal control structure that prevent it from preparing usable financial statements for the Army Working Capital Fund for FY 98. Both the Army and the Defense Finance and Accounting Service have recognized some of the financial reporting weaknesses and reported them in their FY 98 annual assurance statements. They also have initiated actions to improve these deficiencies. However, in most instances, the corrections are years away. Our audit efforts didn't disclose any instances of significant unreported failures to comply with laws and regulations related to the Army Working Capital Fund financial statements. We will present details on our review of internal controls and compliance with laws and regulations in a separate report.

We were unable to express an opinion on the Army Working Capital Fund FY 98 Financial Statements. In this report, we explain the reasons for our disclaimer. We also cite areas where the Army and the Defense Accounting Service are making progress.

To the extent possible, we performed our work in accordance with generally accepted government auditing standards and Office of Management and Budget Bulletin 98-08 (Audit Requirements for Federal Financial Statements). However, as noted in the disclaimer of opinion section of our report, there were limitations to the scope of our work.

Disclaimer of Opinion

We weren't able to determine whether the accompanying principal financial statements fairly presented the financial position, net cost of operations, changes in net position, use of budgetary resources, and sources and uses of financing resources. The accounting systems used to account for the Army Working Capital Fund didn't have complete

general ledger control and, in some instances, lacked adequate audit trails. Because of the accounting system deficiencies, the Army and the Defense Accounting Service used operational systems (supply, logistics, or budgetary systems) to prepare portions of the statements. However, these operational systems also had some deficiencies.

These conditions prevented us from applying other auditing procedures to satisfy ourselves of the reported values for material portions of the financial statements. Therefore, the scope of our work wasn't sufficient to enable us to express, and we don't express, an opinion on these financial statements.

We believe the accounting weaknesses discussed above may also affect the usefulness of information contained in the accompanying overview and any other financial management information taken from the same data sources as the financial statements.

Consolidating Financial Information

The consolidating financial information is not a required part of the principal financial statements, and we did not audit and do not express an opinion on the information. The information is presented for additional analysis of the consolidated financial statements rather than to present the financial position, net cost of operations, changes in net position, use of budgetary resources, and sources and uses of financing resources.

Reasons for Disclaimer

The following paragraphs summarize our results by financial statement. Complete details on these subjects, including specific recommendations, will be in supporting audit reports that we will issue separately.

Balance Sheet

The Army Working Capital Fund Balance Sheet as of 30 September 1998 reported about \$14.2 billion in total assets, \$1.3 billion in liabilities, and \$12.9 billion in equity. Because of accounting system deficiencies, we couldn't determine whether amounts reported in the balance sheet were reasonable and fairly presented. We discuss examples of these deficiencies and their impact on the financial statements in the following paragraphs.

Inventory and Related Property, Net. The Army believed that its logistical records were a better source for determining the value of Inventory and Related Property. Therefore, it adjusted, without reconciling, its

accounting records by about \$3.1 billion so that they agreed with the logistical records. The logistical records sometimes aren't accurate. For example, four of the depots that store Army Working Capital Fund Inventory reported inventory accuracy rates ranging from about 82 percent to about 89 percent. By adjusting, and not reconciling, the accounting records to match the logistical records, the Army couldn't be sure that the inventory balances shown in the balance sheet were reasonable. We were unable to determine which figures were more reasonable to use. However, the low accuracy percentages at the depots decrease the usefulness of the information used to prepare the financial statements.

The Army also had difficulties with inventory held for repair included in the Inventory and Related Property line. The accounting systems don't account for Inventory Held for Repair as required by Statement of Federal Financial Accounting Standards Number 3, "Accounting for Inventory and Related Property." We weren't able to use any practical methodology to determine the value of inventory held for repair. Federal Financial Accounting Standards Number 3 requires inventory in need of repair to be valued net of expected repair expense. A repair allowance account should be established containing the estimated cost to repair inventory coded as needing repair. An expense should be recognized equal to the amount to bring the repair allowance account to the estimated cost of repair for items in inventory needing repair. As expenses are incurred to repair the items, the repair allowance account should be reduced. The lack of a repair expense also impacts the statement of net cost.

Inventory In Transit From Procurement. We couldn't satisfy ourselves as to the reasonableness of the \$595 million reported for inventory in transit from procurement. This account represents assets purchased from contractors for which payments have been made, but receipts haven't been recorded. The Army doesn't account for inventory in transit from procurement using acceptance and receipt transactions. It computes the value by comparing inventory receipts and disbursements made for inventory purchased. We couldn't reasonably use any other auditing procedures to satisfy ourselves as to the reasonableness of the reported amount. DOD has a system change request in process that should fix the reporting problem. However, until it is completed, the reported value will continue to be of limited use.

We also noted that:

- Automated systems rejected receipts for various reasons and personnel sometimes didn't correct the rejected transactions.

- Some inventory classified as in transit had actually been received but not properly recorded.

These actions caused the value to be recorded as both inventory in transit and on hand. We've identified similar results in prior years' audits. Several of our recommendations to the Army and the Defense Accounting Service are still in process.

Government-Furnished Material. We couldn't determine the reasonableness of the \$630 million reported for government-furnished material because of a scope limitation on the ability of logistical or financial management systems to accurately identify consumable material in the possession of contractors. We addressed this problem in the FY 97 audit of the financial statements. The main problem continues to be that contractors rarely report consumption of material to the Army and we didn't have any reasonable way of using alternate auditing procedures to review this item. DOD and the Army have initiated action to make improvements, but solutions may take several years.

Property, Plant and Equipment, Net. We couldn't satisfy ourselves as to the reported value of Property, Plant and Equipment because the Army didn't have documentation supporting the historical cost as required by Statement of Federal Financial Accounting Standards Number 6, "Accounting for Property, Plant, and Equipment." In addition, the Army's depot maintenance activities didn't have a standard financial system in place that provided data needed for accurate financial accounting of real property. We couldn't reasonably use other auditing procedures to satisfy ourselves as to the reported value. (The Depot Maintenance activities have about 98 percent of the Army Working Capital Fund Property, Plant and Equipment.) The current real property system (Integrated Facilities System) didn't:

- Reconcile accounting data with supporting property records.
- Identify and track the cost of real property.
- Identify costs incurred to maintain real property.
- Capitalize and depreciate real property.

The Army submitted a system change request to make the Integrated Facilities System and the Defense Property Accountability System—the system that performs financial accounting for equipment—share information. Implementing this change would allow the Accountability System to perform the financial accounting of real property. The goal is to complete the interface sometime during FY 00.

Statement of Net Cost/Statement of Changes in Net Position

The automated accounting systems used to account for transactions that affected the Statement of Net Cost and the Statement of Net Position didn't maintain sufficient data to trace transactions to the general ledger. Therefore, we couldn't determine whether the information was reasonable and fairly stated. For example, we couldn't determine whether the \$9 billion reported as revenue for the supply business area was reasonable and fairly stated because the general ledger, used to account for the supply business area's revenues, didn't agree with the Financial Transaction Register. We couldn't apply any practical audit methodology to determine if the general ledger or the Financial Transaction Register was more reliable.

Statement of Budgetary Resources

We couldn't determine whether the reported amounts in the Statement of Budgetary Resources were reasonable and fairly stated because much of the information included in the statement came from sources other than the general ledger system. It came from the Defense Finance and Accounting Service-Indianapolis Center's cash expenditure and collection reporting system, and budgetary status reports. The Indianapolis Center used these sources to prepare the statement of budgetary resources because general ledgers produced by the accounting systems at the fiscal stations didn't contain necessary data in sufficient detail. However, we couldn't tell whether the information was reasonable because, in some instances, the information was computed using gross numbers without detailed transactions supporting the figures. These issues limited the scope of our review and prevented us from reasonably using other auditing procedures to review the amounts included in the financial statement.

Statement of Financing

The Statement of Financing is prepared using information from the same systems that the Defense Accounting Service used to prepare the Statement of Net Cost and the Statement of Budgetary Resources. Because of the scope limitation we encountered during our review of those two financial statements, we couldn't determine whether the information included in the Statement of Financing was fairly presented.

Other Reporting Problems

We found other problems which don't preclude us from rendering an audit opinion, but which the Army must resolve to ensure the affected

data is properly presented in the Army Working Capital Fund financial statements.

Financial Management Systems

The Defense Accounting Service's financial management systems didn't meet all aspects of the Federal Financial Management Improvement Act of 1996. The lack of a single integrated general ledger and the differences between certified reports and general ledger accounts caused the financial statement process at the Indianapolis Center to be complicated and lengthy. The process produced adjustments to the financial statements that sometimes weren't supported with detailed documentation.

Several of our disclaimer points in this report are the result of inadequate accounting systems, but poor controls or accounting applications that needed to be modified caused other points. Efforts were in process to resolve the inadequate accounting systems. We will make recommendations in other audit reports to improve internal controls and to change the accounting applications.

Financial Statement Compilation

The Indianapolis Center encountered numerous problems preparing the Army Working Capital Fund FY 98 Financial Statements. It tried to use a new automated system to compile the financial statements without testing the system first. As a result, it encountered difficulties putting out the financial statements within its established timeframes. Until the Indianapolis Center begins to meet its reporting deadlines and improve its plan for preparing the financial statements, it may continue to encounter problems preparing the financial statements.

Allowance Account

The Army continues to have internal control problems related to recording and reporting amounts shown in the Allowance for Unrealized Holding Gains and Loss account. The account included some costs that should have been expensed as incurred. Some logistical transactions weren't included in the account. Rejected transactions sometimes weren't researched, corrected, and entered in the financial records. The Standard Army Financial Inventory Accounting System-Current sometimes doesn't keep rejected transactions. The system doesn't produce a monthend open reject report. Accounting technicians must access the rejects through the system. The system drops rejected transactions after 90 days even if accounting personnel haven't cleared the transactions. This same condition doesn't exist in the upgraded Standard Army

Financial Inventory Accounting System-Modification that the Army is implementing.

The Statement of Federal Financial Accounting Standards Number 3, "Accounting for Inventory and Related Property" requires inventory to be valued at historical cost or an estimate of historical cost using the allowance account. When the allowance account is used, the balance in the account should represent the difference between inventory at latest acquisition cost and historical cost. Therefore, when inventory is presented net of the allowance account, an estimate of historical cost results. Until the allowance account issue is resolved, we don't believe that the balance in the account will reduce inventory to an accurate estimate of historical cost.

Progress Areas

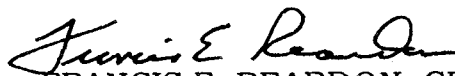
The Army and the Defense Accounting Service have developed action plans to improve the Army Working Capital Fund financial statements. Each has initiatives in process that should contribute to this goal. For example, the Army developed a plan to improve its overall financial reporting and continued to work with the DOD-wide Real Property Integrated Process Team. The team made progress in FY 98 by successfully creating, passing, and implementing a Systems Change Request that will assist the real property management systems and the Accountability System to share information. The team's goal is to begin testing the change in March 1999 and have the change fully implemented sometime in FY 00.

The Defense Accounting Service continued its emphasis on improving its processes. During FY 98, it improved its support of adjustments over prior years but still had problems documenting some adjustments. It also continued to consolidate disbursing stations into one centralized station at Indianapolis. Once fully implemented, this centralized disbursing station concept will allow all payments to eventually be considered "for self" transactions and, thus, eliminate problematic "for other" transactions.

The Defense Accounting Service also continued its move towards consolidating and standardizing financial systems and operations. The service is identifying the best financial payment systems in its inventory, modifying the systems to meet DOD-wide requirements, and implementing them as migratory systems throughout DOD.

Outlook

Both the Army and the Defense Accounting Service made some improvements during FY 98, and the actions under way should improve financial reporting and integrate functional and financial management, as intended by the Chief Financial Officers Act. They give evidence both to the Army's and the Defense Accounting Service's commitment to the act and the progress toward successful implementation. Although problems remain and solutions are still years away, the outlook is positive.


FRANCIS E. REARDON, CPA
The Auditor General

ANNEXES

AUDIT SCOPE AND METHODOLOGY

Army management, with support provided by the Defense Finance and Accounting Service, is responsible for:

- Preparing the annual financial statements in conformity with applicable accounting principles.
- Establishing and maintaining internal controls and systems to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met.
- Complying with applicable laws and regulations.

We were responsible for auditing the financial statements and evaluating related internal controls and compliance with laws and regulations. In carrying out these responsibilities, we:

- Evaluated and, as necessary, tested relevant internal controls encompassing:
 - Fund Balance With Treasury.
 - Inventory and Related Property, Net.
 - General Property, Plant and Equipment.
 - Statement of Budgetary Resources.
 - Statement of Net Cost and Statement of Changes in Net Position.
 - Financial Statement Compilation Procedures.
- Conducted followup reviews on previous recommendations related to the Army Working Capital Fund.
- Tested compliance with selected laws and regulations.

We didn't conduct audit work on programs that were classified for national security purposes.

To the extent possible, we performed our work in accordance with generally accepted government auditing standards and Office of

ANNEX A

Management and Budget Bulletin 98-08 (Audit Requirements for Federal Financial Statements). However, as noted in the body of our report, there were limitations to the scope of our work.

ARMY WORKING CAPITAL FUND CONSOLIDATING FINANCIAL STATEMENTS FOR FISCAL YEAR 1998

The final consolidating financial statements for Army Working Capital Fund activities for fiscal year 1998 are in this annex. We didn't include the overview and the financial statements and related footnotes for the individual business areas.

DEPARTMENT OF ARMY

***WORKING CAPITAL
FUND***

***CONSOLIDATED
STATEMENTS***

Department of Defense
Army Working Capital Fund
BALANCE SHEET
As of September 30, 1998
(\$ in Thousands)

	<u>FY</u> <u>1998</u>
ASSETS	
1. Entity Assets:	
A. Intragovernmental	
(1) Fund Balance with Treasury (Note 2)	\$364,611
(2) Investments (Note 4)	0
(3) Accounts Receivable, Net (Note 5)	301,808
(4) Other Assets (Note 6)	0
B. Total Intragovernmental	<u>\$666,419</u>
C. Investments, Net (Note 4)	0
D. Accounts Receivable, Net (Note 5)	143
E. Credit Program Receivables and Related Foreclosed Property, Net (Note 7)	0
F. Cash and Other Monetary Assets (Note 3)	0
G. Inventory and Related Property, Net (Note 8)	10,529,026
H. General Property, Plant and Equipment (Note 9)	1,916,823
I. Stewardship Assets (National Defense PP&E, etc.)	N/A
J. Other Assets (Note 6)	1,058,052
K. Total Entity Assets	<u>\$14,170,463</u>
2. Non-Entity Assets:	
A. Intragovernmental	
(1) Fund Balance with Treasury (Note 2)	0
(2) Accounts Receivable, Net (Note 5)	0
(3) Other Assets (Note 6)	0
B. Total Intragovernmental	<u>\$0</u>
C. Accounts Receivable, Net (Note 5)	0
D. Cash and Other Monetary Assets (Note 3)	0
E. Other Assets (Note 6)	0
F. Total Non-Entity Assets	<u>\$0</u>
3. Total Assets	<u><u>\$14,170,463</u></u>

The accompanying notes are an integral part of these statements.

**Principal
Statements****Department of Defense
Army Working Capital Fund
BALANCE SHEET
As of September 30, 1998
(\$ in Thousands)****FY
1998****LIABILITIES****4. Liabilities Covered by Budgetary Resources:**

A. Intragovernmental Liabilities	
(1) Accounts Payable	\$248,387
(2) Environmental Cleanup (Note 11)	0
(3) Debt (Note 10)	0
(4) Other Intragovernmental Liabilities (Notes 11, 12, and 15)	0
B. Total Intragovernmental Liabilities	<u>\$248,387</u>
C. Accounts Payable	412,486
D. Liabilities for Loan Guarantees	0
E. Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Note 13)	0
F. Environmental Cleanup (Note 11)	0
G. Other Liabilities (Note 11, 12, and 15)	232,419
H. Total Liabilities Covered by Budgetary Resources:	<u>\$893,292</u>

5. Liabilities Not Covered by Budgetary Resources:

A. Intragovernmental Liabilities	
(1) Accounts Payable	0
(2) Debt (Note-9)	0
(3) Environmental Cleanup (Note 11)	0
(4) Other Liabilities (Notes 11, 12 and 15)	0
B. Total Intragovernmental Liabilities	<u>\$0</u>
C. Accounts Payable	0
D. Debt (Note 10)	0
E. Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Note 13)	129,854
F. Environmental Cleanup (Note 11)	277,185
G. Other Liabilities (Notes 11, 12 and 15)	6,079
H. Total Liabilities Not Covered by Budgetary Resources	<u>\$413,118</u>

6. Total Liabilities

1,306,410

NET POSITION

7. Unexpended Appropriations (Note 14)	(225,439)
8. Cumulative Results of Operations	13,089,492
9. Total Net Position	<u>\$12,864,053</u>

10. Total Liabilities and Net Position\$14,170,463

The accompanying notes are an integral part of these statements.

**Principal
Statements**

**Department of Defense
Army Working Capital Fund
STATEMENT OF NET COST
For the Period Ending September 30, 1998
(\$ in Thousands)**

	<u>FY</u> <u>1998</u>
1. Program Costs	
A. Intragovernmental	\$6,888,435
B. Public	3,446,133
C. Total Program Cost	<u>\$10,334,568</u>
D. Less Earned Revenues	<u>(9,396,699)</u>
E. Net Program Costs	<u>\$937,869</u>
2. Costs Not Assigned to Programs	\$0
3. Less Earned Revenues Not Attributable to Programs	\$0
4. Deferred Maintenance (Note 17)	
5. Net Cost of Operations	<u><u>\$937,869</u></u>

Additional information included in Note 16.

**The accompanying notes are an integral part of
these statements.**

**Principal
Statements**

**Department of Defense
Army Working Capital Fund
STATEMENT OF CHANGES IN NET POSITION
For the Period Ending September 30, 1998
(\$ in Thousands)**

	FY 1998
1. Net Cost of Operations	\$937,869
2. Financing Sources (Other than Exchange Revenues):	
A. Appropriations Used	0
B. Taxes (and Other Non-exchange Revenue)	0
C. Donations (Non-exchange Revenue)	0
D. Imputed Financing	89,997
E. Transfers-In	2,051,790
F. Transfers-Out	(1,153,620)
	<hr/>
3. Net Results of Operations (Line 2 less Line 1)	\$50,298
	<hr/>
4. Prior Period Adjustments (Note 18)	228,093
	<hr/>
5. Net Change in Cumulative Results of Operations	278,391
	<hr/>
6. Increase (Decrease) in Unexpended Appropriations	0
	<hr/>
7. Change in Net Position	278,391
	<hr/>
8. Net Position-Beginning of Period	12,585,662
	<hr/>
9. Net Position-End of Period	\$12,864,053
	<hr/>

Additional information included in Note 18.

The accompanying notes are an integral part of these statements.

**Principal
Statements**

**Department of Defense
Army Working Capital Fund
STATEMENT OF BUDGETARY
RESOURCES
For the Period Ending September 30, 1998
(\$ in Thousands)**

**FY
1998**

BUDGETARY RESOURCES

1. Budget Authority	\$666
2. Unobligated Balance – Beginning of Period	1,070,635
3. Net Transfers Prior-Year Balance, Actual (+-)	17,700
4. Spending Authority from Offsetting Collections	8,175,279
5. Adjustments	142,223
6. Total Budgetary Resources	<u>\$9,406,503</u>

STATUS OF BUDGETARY RESOURCES

7. Obligations Incurred	8,267,749
8. Unobligated Balances - Available	1,138,754
9. Unobligated Balances – Not Available	0
10. Total Status of Budgetary Resources	<u>\$9,406,503</u>

OUTLAYS

11. Obligations Incurred	8,267,749
12. Less: Spending Authority From Offsetting Collections & Adjustments	(8,324,155)
13. Obligated Balance, Net – Beginning of Period	702,240
14. Obligated Balance Transferred, Net	0
15. Less: Obligated Balance, Net – End of Period	(586,904)
16. Total Outlays	<u>\$58,930</u>

Additional information included in Note 19.

**The accompanying notes are an integral part of these
statements.**

**Principal
Statements****Department of Defense
Army Working Capital Fund
STATEMENT OF FINANCING
For the Period Ending September 30, 1998
(\$ in Thousands)**

	FY 1998
1. OBLIGATIONS AND NONBUDGETARY RESOURCES:	
A. Obligations Incurred	\$8,267,749
B. Less: Spending Authority for Offsetting Collections and Adjustments	(8,324,155)
C. Donations Not in the Entity's Budget	0
D. Financing Imputed for Cost Subsidies	21,997
E. Transfers-In (Out)	89,170
F. Exchange Revenue Not in the Entity's Budget	12,709
G. Other	0
H. Total Obligations as Adjusted and Nonbudgetary Resources	<u>\$1,061,470</u>
2. RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS:	
A. Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Received or Provided	(997,871)
B. Costs Capitalized on the Balance Sheet	(329,074)
C. Financing Sources That Fund Costs of Prior Periods	111,562
D. Other	0
E. Total Resources That Do Not Fund Net Costs of Operations	<u>(\$1,215,383)</u>
3. COSTS THAT DO NOT REQUIRE RESOURCES:	
A. Depreciation & Amortization	53,700
B. Revaluation of Assets & Liabilities	931,887
C. Other	1,353
D. Total Costs That Do Not Require Resources	<u>\$986,940</u>
4. Financing Sources Yet to be Provided	<u>104,842</u>
5. Net Cost of Operations	<u><u>\$937,869</u></u>

Additional information included in Note 20.

The accompanying notes are an integral part of these statements.

Footnotes to the Consolidated Statements

Note 1: Significant Accounting Policies

A. Basis of Presentation.

These financial statements have been prepared to report the financial position and results of operations of the Army Working Capital Fund (AWCF), as required by the Chief Financial Officers (CFO) Act expanded by the Government Management Reform Act (GMRA) of 1994, and other appropriate legislation. The report has also been prepared to provide information with which Congress, agency managers, the public, and other interested parties can assess management performance and stewardship. The financial statements have been prepared from the books and records of the AWCF in accordance with DoD Financial Management Regulation Volume 6B, as adopted from Office of Management and Budget (OMB) Bulletin No. 97-01, "Form and Content of Agency Financial Statements." These statements, therefore, are different from the financial reports, also prepared by the AWCF pursuant to OMB directives, that are used to monitor and control AWCF's use of budgetary resources.

B. Reporting Entity.

Historically the Department of the Army has operated a significant number of its organic commercial and industrial facilities as revolving funds to control inventory and provide goods and services used to support both peacetime and wartime operations. Beginning in FY 1991 the funds used to operate these functions were consolidated with other like functions from other Department of Defense Agencies to form the Defense Business Operations Fund. In FY 1997 this was changed to the Working Capital Fund. Fiscal year 1998 represents the seventh year that the Army has prepared financial statements for this fund as required by the CFO Act and the GMRA.

The accounts used to prepare the statements are classified as entity/nonentity. Entity accounts consist of resources that the agency has the authority to decide how to use, or where management is legally obligated to use funds to meet entity obligations. Non-entity accounts are assets that are held by an entity but are not available for use in operations. In FY 1998 the AWCF held no non-entity assets.

The accompanying financial statements account for all Working Capital Funds, excluding the Conventional Ammunition Working Capital Fund, for which the Army is responsible except that information relative to classified assets, programs, and operations have been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. The audited financial statements are presented on the accrual basis of accounting as required by DoD accounting policies.

C. Budgets and Budgetary Accounting

The Department of Defense expanded the use of businesslike financial management practices through the establishment of the Defense Business Operations Fund (DBOF) on

October 1, 1991. On December 11, 1996, the DBOF became the Defense Working Capital Fund (DWCF) which included the Army Working Capital Fund (AWCF). The AWCF operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision making process. The AWCF builds on revolving fund principles previously used for industrial and commercial-type activities. The Department of the Army's working capital funds are primarily included within the AWCF and finance industrial and commercial type transactions. Receipts derived from operations are normally available in their entirety for use without further congressional action.

D. Basis of Accounting.

Transactions are generally recorded on an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash... Budgetary accounting is accomplished through unique general ledger accounts to facilitate compliance with legal and internal control requirements associated with the use of federal funds. All known intrafund balances have been eliminated.

E. Revenues and Other Financing Sources.

Revenue for business fund activities is recognized at the point the rendered service is completed and billed or at the point inventory items are sold. Revolving funds are funded by revenues generated by sales of goods and services through a reimbursable order process. This process allows the seller to increase funds available by recording a sale for the cost of the supplies and/or services ordered by the customer. Funds received prior to delivery of the goods or services are treated as unearned revenue and recorded as a liability.

For financial reporting purposes under accrual accounting, operating expenses are recognized in the period incurred. Expenditures for capital and other long-term assets are not recognized as expenses until consumed in the AWCF's operations. Unexpended funds are recorded as equity of the U.S. Government.

F. Accounting for Intragovernmental Activities.

The AWCF, as a component of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the AWCF as though the fund were a stand-alone entity.

1. The AWCF's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related interests costs are not apportioned to federal agencies. The AWCF's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

2. Financing for the construction of AWCF facilities is obtained through budget appropriations. To the extent this financing may have been ultimately obtained through the issuance of public debt, interest costs have not been capitalized since the Treasury Department does not allocate interest costs to the benefiting agencies.

3. The Department's civilian employees participate in the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The AWCF funds a portion of the civilian and military pensions. Reporting civilian pension benefits under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management. The AWCF recognizes an imputed expense for civilian employee pensions and other retirement benefits in the statement of net cost; and recognizes imputed revenue for the civilian employee pensions and other retirement benefits in the statement of changes in net position. The AWCF reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Trust Fund CFO report. The AWCF recognizes the actuarial liability for the military retirement health benefits in the DoD Agency-wide statements. In fiscal year 1998, the Fund contributed the following amounts to the retirement plans and Social Security.

	(in thousands)
CSRS	\$47,512
FERS	29,053
Social Security	<u>33,761</u>
	<u>\$110,326</u>

The Fund also contributed \$11.6 million to the FERS Thrift Savings Plan on behalf of its participating employees.

4. Most legal actions, other than contract claims, to which the AWCF may be a named party are covered by the provisions of the Federal Tort Claims Act and the provisions of Title 10, United States Code, Chapter 163, governing military claims. Either because payments under these statutes are limited to amounts well below the threshold of materiality for claims payable from the AWCF's fund balance or because payments will be from the permanent, indefinite appropriation "Claims, Judgments, and Relief Acts" (the Judgment Fund), these legal actions should not materially affect the AWCF's operations or financial condition.

5. In fiscal year 1998, the AWCF sold assets to foreign governments under the provisions of the Arms Export Control Act of 1976. Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries, generally at no profit or loss to the U.S. Government. Customers are required to make payments in advance to a trust fund maintained by the Department of the Treasury from which the Military Services are reimbursed for the cost of administering and executing the sales. In fiscal year 1998, the AWCF received reimbursements of \$325.242 thousand for assets and services sold under the Foreign Military Sales program.

G. Funds with the U.S. Treasury and Cash.

The AWCF's financial resources are maintained in U.S. Treasury accounts. Its cash receipts and disbursements are processed by the Treasury Department, and the balance with the U.S. Treasury represents the aggregate of all unexpended balances.

H. Foreign Currency.

The AWCF engaged in no foreign currency transactions in FY 1998.

I. Accounts Receivable.

As presented in the balance sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other entities. Allowances for uncollectable accounts are based upon analysis of collection experience.

J. Loans Receivable.

The AWCF reported no Loans Receivable in FY 1998.

K. Inventories.

Inventories, including operating supplies and nonconsumable items, are valued at: Latest Acquisition Cost (LAC). LAC is determined by subtracting appropriate surcharges from the Standard Cost to arrive at the price most recently paid for a carried item. Gains and losses that result from valuation changes for inventory items are recognized and reported in the net cost statement and included in the calculation of the cost of goods sold.

L. Investments in U.S. Government Securities.

The AWCF has no investments in U.S. Government Securities.

M. General Property, Plant and Equipment.

All PP&E is categorized as General PP&E, whether or not it meets the definition of a Stewardship Asset. Prior to FY 1996, General PP&E with an acquisition cost of \$15,000, \$25,000, and \$50,000 for FY 1993, FY 1994, and FY 1995, respectively, and an estimated useful life of two years or more was capitalized, remains capitalized for the AWCF.

N. Prepaid and Deferred Charges.

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and reported as an asset on the Statement of Financial Position. Prepaid charges are recognized as expenditures and expenses when the related goods and services are received.

O. Leases.

The AWCF is committed to no operating leases or rental agreements.

P. Contingencies.

At any given time, the Department may be a party to various legal and administrative actions and claims brought against it. These relate primarily to tort claims resulting from vehicle accidents, property and environmental damages resulting from AWCF activities, and contract disputes.

Most legal actions, other than contract claims, to which the AWCF may be a named party are covered by the provisions of the Federal Tort Claims Act and the provisions of Title 10, United States Code, Chapter 163, governing military claims. Either because payments under these statutes are limited to, amounts well below the threshold of materiality for claims payable from the AWCF's fund balance or because payments will be from the permanent, indefinite appropriation "Claims, Judgments, and Relief Acts" (the Judgment Fund), these legal actions should not materially affect the AWCF's operations or financial condition.

Q. Accrued Leave.

Civilian annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for annual and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of nonvested leave are expensed as taken. Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates.

R. Equity.

Equity consists of unexpended appropriations and cumulative result of operations. Unexpended appropriations represent amounts of authority which are unobligated and have not been rescinded or withdrawn, and amounts obligated but for which neither legal liabilities for payments have been incurred nor actual payments made.

Cumulative results of operations for AWCF represents the excess of revenues over expenses since fund inception, less refunds to customers and returns to the U.S. Treasury.

S. Treaties for Use of Foreign Bases.

There were no AWCF activities involving the use of foreign bases in FY 1998.

T. Comparative Data.

Comparative data for the prior year has not been presented because this is the first year for which financial statements are prepared using the OMB 97-01 prescribed format. In

future years, comparative data will be presented in order to provide an understanding of changes in the financial position and operations of the Department's reporting activities.

U. Undelivered Orders.

The AWCF is obligated for goods and services which have been ordered but not yet received (undelivered orders) and thus do not represent a liability for payment. The AWCF has Undelivered Orders outstanding at the end of FY 1998 of \$2.996 billion

NOTE 2: Fund Balances with Treasury (\$ in Thousands)

	<u>Revolving Funds</u>
A. Entity Fund and Account Balances:	
Unobligated Balances Available:	
Available	\$1,138,754
Restricted	0
Reserve for Anticipated Resources	0
Obligated Balance, Net	586,903
Unfunded Contract Authority	(1,361,046)
Unused Borrowing Authority	
Total Entity Treasury Balance	<u>\$364,611</u>
B. Non-Entity Fund and Account Balance	<u>\$0</u>

C. The Fund Balance with Treasury does not include any amounts for which The Department of Treasury is willing to accept corrections to canceled appropriation accounts, in accordance with SFFAS Number 1.

D. Other Information: None

NOTE 3. Cash, Foreign Currency and Other Monetary Assets Not applicable

NOTE 4. Investments, Net Not applicable

NOTE 5. Accounts Receivable, Net
(\$ in Thousands)

	Gross Amount Due	Allowance for Estimated Uncollectibles	Net Amount Due
A. Entity Receivables			
Intragovernmental	\$301,808	N/A	\$301,808
With the Public	\$143	\$0	\$143
B. Non-Entity Receivables			
Intragovernmental	\$0	N/A	\$0
With the Public	\$0	\$0	\$0

C. Allowance Method Used:

D. Other Information: Calculation of allowance for estimated uncollectibles was based on actual uncollectible amounts written off during the past three fiscal years. Amounts written off during those years were insignificant, therefore no estimate is entered. Amount shown is net of accounts receivable and unearned revenue. This has resulted in an abnormal balance for accounts receivable with the public in the Ordnance Business Area. See Note 1I for additional comments.

NOTE 6. Other Assets

(\$ in Thousands)

A. Other Entity Assets:

1. Intragovernmental

(a) Assets Returned for Credit	\$0
(b) Advances	0
(c) Other	0
Total Intragovernmental	<u>\$0</u>

2. Other

(a) Cash Advances	\$259,103
(b) Equipment Not In Use	48,175
(c) Other	750,774
Total Other	<u>\$1,058,052</u>

B. Other information related to entity assets. None

C. Other Non-entity Assets:

1. Intragovernmental

(a)	\$0
(b)	0
Total	<u>\$0</u>

2. Governmental

(a)	\$0
(b)	0
Total	<u>\$0</u>

NOTE 7. Loans and Loan Guarantees, Non-Federal Borrowers Not applicable

NOTE 8. Inventory and Other Related Property

Note 8A. Inventory
(\$ in Thousands)

	Inventory Amount	Allowance for (Gains) Losses	Inventory, Net	Valuation Method
1. Inventory Categories:				
(a) Held for Current Sale	\$11,412,140	\$2,042,765	\$9,369,375	See A3
(b) Held in Reserve for Future Sale	1,241,137	265,119	976,018	See A3
(c) Excess, Obsolete and Unserviceable	39,698	0	39,698	See A3
(d) Held for Repair	0	0	0	
Total	<u>\$12,692,975</u>	<u>\$2,307,884</u>	<u>\$10,385,091</u>	

2. Restrictions on Inventory Use, Sale or Disposition:

3. Other Information: Inventory is valued at standard price less surcharge (Latest Acquisition Cost), less the value of potentially excess inventory. Surcharges are based on a percentage of potential excess derived from the March stratification report and applied to the September 30, 1997 inventory balances. Excess, obsolete and unserviceable material is valued at estimated net realizable value.

During the 1970's, \$56.774 million was provided to the Army and Air Force Exchange Service to provide supplies to the soldiers. The Exchange Service used this money to establish an inventory and it requisitions merchandise directly from DLA. This process isn't in accordance with accounting principles or regulations. Actions are currently underway to identify and remove it from the inventory balances.

Legend: Valuation Methods

LAC = Latest Acquisition Cost

SP = Standard Price

AC = Actual Cost

NRV = Net Realizable Value

O = Other

NOTE 8B. Operating Materials and Supplies (OM&S)
(\$ in Thousands)

	<u>OM&S Amount</u>	<u>Allowance for (Gains) Losses</u>	<u>OPM&S Net</u>	<u>Valuation Method</u>
1. OM&S Categories:				
(a) Held for Current Sale	\$87,357	\$0	\$87,357	See B3
(b) Held in Reserve for Future Sale	55,129	0	55,129	See B3
(c) Excess, Obsolete and Unserviceable	1,449	0	1,449	See B3
Total	<u>\$143,935</u>	<u>\$0</u>	<u>\$143,935</u>	

2. Restrictions on operating materials and supplies:

3.. Other Information: Inventories are valued at the standard prices established by the National Inventory Control Point. Excess, obsolete and unserviceable material is valued at estimated net realizable value.

Legend: Valuation Methods

LAC = Latest Acquisition Cost

SP = Standard Price

AC = Actual Cost

NRV = Net Realizable Value

O = Other

NOTE 8C. Stockpile Materials Not applicableNOTE 8D. Seized Property Not applicableNOTE 8E. Forfeited Property, Net Not applicableNOTE 8F. Goods Held Under Price Support and Stabilization Programs, Net Not applicable

NOTE 8. Recap of Inventory and Other Related Property
(\$ in Thousands)

	<u>Amount</u>
Inventory, Net	\$10,385,091
Operating Materials and Supplies, Net	143,935
Stockpile Materials, Net	
Seized Property, Net	
Forfeited Property, Net	
Total	<u><u>\$10,529,026</u></u>

NOTE 9 Property, Plant, and Equipment
(\$ in Thousands)

Major Classes of Assets	Depreciation Method	Service Life	Acquisition Values	Accumulated Depreciation	Net Book Value
A. Land	NA		\$13,056	\$0	\$13,056
B. Structure, Facilities, and Leasehold Improvements	SL	11-20	1,829,391	671,361	1,158,030
C. ADP Software	SL	1-5	74	17	57
D. Equipment	SL	1-5	1,373,258	644,135	729,123
E. Assets Under Capital Lease	SL		42	42	0
F. Construction-in-Progress	NA	6-10	16,387	0	16,387
G. Other			2,889	2,719	170
Total			<u><u>\$3,235,097</u></u>	<u><u>\$1,318,274</u></u>	<u><u>\$1,916,823</u></u>

H. Other Information: Line E. Equipment includes the amount of equipment intransit.
Equipment intransit is not depreciated.

Legends:

Depreciation Methods

SL - Straight Line

OT - Other

NOTE 10. Debt: Not applicable

NOTE 11. Other Liabilities**Note 11A. Environmental Cleanup:**

(\$ in Thousands)

1. Environmental Cleanup Liabilities Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
(a) Intragovernmental			
(1) Accrued Cleanup Costs	0	0	0
(2) Other Environmental Liabilities	0	0	0
Total	0	0	0
(b) With the Public			
(1) Accrued Cleanup Costs	0	0	0
(2) Other Environmental Liabilities	0	0	0
Total	0	0	0

2. Environmental Cleanup Liabilities Not Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
(a) Intragovernmental			
(1) Accrued Cleanup Costs	0	0	0
(2) Other Environmental Liabilities	0	0	0
Total	0	0	0
(b) With the Public			
(1) Accrued Cleanup Costs	277,185	0	277,185
(2) Other Environmental Liabilities	0	0	0
Total	277,185	0	277,185

3. Other Information: The environmental cleanup costs will be paid from other appropriated funds. They are shown on these statements only to reflect that the costs were incurred through the operations of the AWCF.

Note 11B. Other Liabilities:
(\$ in Thousands)

1. Other Liabilities Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
a. Intragovernmental			
(1) Advances from Others	\$0	\$0	\$0
(2) Deferred Credits	0	0	0
(3) Deposit Funds and Suspense Account Liabilities	0	0	0
(4) Liability for Borrowings to be Received	0	0	0
(5) Liability for Subsidy Related to Undisbursed Loans	0	0	0
(6) Other Liabilities	0	0	0
(7) Resources Payable to Treasury	0	0	0
Total	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

b. With the Public

(1) Accrued Funded Payroll and Benefits	\$0	\$145,466	\$145,466
(2) Advances from Others	0	0	0
(3) Deferred Credits	0	4,498	4,498
(4) Deposit Funds and Suspense Accounts	0	0	0
(5) Other Liabilities	0	82,455	82,455
Total	<u>\$0</u>	<u>\$232,419</u>	<u>\$232,419</u>

2. Other Information

3. Other Liabilities not Covered by Budgetary Resources:

	Noncurrent Liability	Current Liability	Total
a. Intragovernmental			
(1) Accounts Payable - Canceled Accounts	\$0	\$0	\$0
(2) Custodial Liability	0	0	0
(3) Deferred Credits	0	0	0
(4) Liability for Borrowings to be Received	0	0	0
(5) Other Actuarial Liabilities	0	0	0
(6) Other Liabilities	0	0	0
Total	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
b. With the Public			
(1) Accounts Payable Canceled	\$0	\$0	\$0
(2) Accrued Cleanup/Cost	0	0	0
(3) Accrued Unfunded Liabilities	0	0	0
(4) Deferred Credits	0	0	0
(5) Other Liabilities	0	6,079	6,079
(6) Prior Liens Outstanding on Acquired Collateral	0	0	0
Total	<u>\$0</u>	<u>\$6,079</u>	<u>\$6,079</u>

NOTE 12. Leases Not applicable

NOTE 13. Pensions and Other Actuarial Liabilities :
(\$ in Thousands)

Major Program Activities	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	Assets Available to Pay Benefits	Unfunded Actuarial Liability
A. Pension and Health Plans				
B. Insurance/Annuity Programs:				
C. Other:				
1. Workman's Compensation	129,854		0	129,854
D. Total Lines A+B+C	<u>\$129,854</u>		<u>\$0</u>	<u>\$129,854</u>

E. Other Information: Future workers' compensation figures are provided by the Department of Labor. The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

1998	1997
5.60% in year 1, and thereafter	6.24 % in year 1 5.82 % in year 2 5.60 % in year 3 5.45 % in year 4 5.40 % in year 5 and thereafter

NOTE 14. Unexpended Appropriations

(\$ in Thousands)

A. Unexpended Appropriations	
1. Unobligated	
a. Available	(225,438)
b. Unavailable	
2. Undelivered Orders	
Total	<u>(225,438)</u>

B. Other Information: The balance shown for available appropriations was carried forward from the initial capitalization of the maintenance and ordnance depots into the Army Industrial Fund. The amount is under review to determine its validity.

NOTE 15. Contingencies: Not applicable

NOTE 16. Footnote Disclosures Related to the Statement of Net Costs

Note 16.A. Suborganization Program Costs. Working Capital Funds are reported as only one program.

Note 16.B. Cost of National Defense PP&E Not applicable.

Note 16.C. Cost of Stewardship Assets Not applicable

Note 16.D. Stewardship Assets Transferred Not applicable

Note 16.E. Exchange Revenue AWCF pricing is based on full cost or market pricing.

Note 16.F. Revenue and Expense Amounts for Foreign Military Sales (FMS) Program Procurements From Contractors Not applicable

Note 16.G. Benefit Program Expenses Not applicable.

Note 16.H. Gross Cost and Earned Revenue by Budget Functional Classification
(\$ in Thousands)

	Budget Function Code	Gross Cost	Earned Revenue	Net Cost
A. Department of Defense Military	051	\$10,334,568	\$9,396,699	\$937,869
B. Water Resources by US Army Corps of Engineers	301			
C. Pollution Control and Abatement by US Army Corps of Engineers	304			
D. Federal Employee Retirement and Disability by Department of Defense Military Retirement Trust Fund	602			
E. Veterans Education, Training, and Rehabilitation by Department of Defense Education Benefits Trust Fund	702			
Total		<u>\$10,334,568</u>	<u>\$9,396,699</u>	<u>\$937,869</u>

Note 16.I. Imputed Expenses
(\$ in Thousands)

A. Other Information:

A. Employees Pensions	
1. Civil Service Retirement System	\$42,508
2. Federal Employees Retirement System	925
Total Pensions	<u>\$43,433</u>
B. Federal Employees Health Benefit Program	46,405
C. Federal Employees Group Life Insurance	159
	<u>\$89,997</u>

NOTE 17. Deferred Maintenance on PP&E

Note 17A Summary of Deferred Maintenance Amounts By Category of Property, Plant, and Equipment Not applicable

Note 17B. General Property, Plant, and Equipment Deferred Maintenance Amounts Not applicable

Note 17C. National Defense Property, Plant, and Equipment Deferred Maintenance Amounts Not applicable

NOTE 18. Footnote Disclosures Related to the Statement of Changes in Net Position

Note 18A Prior Period Adjustments
(\$ in Thousands)

A. Prior Period Adjustments

1. Changes in Accounting Standards	\$0
2. Errors and Omission in Proir Year Accounting Reports.	228,093
3. Other	0
Total	<u>\$228,093</u>

B. Other Information: Prior period adjustments are composed of \$191 million for underutilized and BRAC operating losses and \$378 million for receipt of previously undistributed software costs incurred by the Joint Logistics Center. These adjustments were reduced by \$57 million for refund of overpayments of material return credits from OMA and \$350 million for adjustments made to properly close out prior year revenue and expense accounts not reported by field activities. The remaining balance of \$68 million is composed of miscellaneous adjustments received made by the field activities.

Note 18 B. Other Disclosures to the Statement of Changes in Net Position A reduction of \$104 million in environmental cleanup liabilities realized during FY 1998 was reported as Other Expenses. Operations and Maintenance-Army paid for \$18.5 million of this reduction. The remaining reduction is due to a cleanup of environmental data files and by created efficiencies which have resulted in revisions of individual cost estimates. This reduction was not budgeted for nor made through the use of AWCF funds.

Imputed expenses for employee benefits were incurred as follows:

A. Employees Pensions	
1. Civil Service Retirement System	\$42,508
2. Federal Employees Retirement System	925
Total Pensions	<u>\$43,433</u>
 B. Federal Employees Health Benefit Program	 46,405
 C. Federal Employees Group Life Insurance	 159
	<u><u>\$89,997</u></u>

NOTE 19 Disclosures Related to the Statement of Budgetary Resources
(\$ in Thousands)

1. Net amount of Budgetary Resources Obligated for Undelivered Orders at the End of Period	\$2,996,006
2. Available Borrowing and Contract Authority at the End of Period	1,361,046

3. Other Information: Transfers consists only of cash transfers.

NOTE 20. Disclosures Related to the Statement of Financing:

Transfers In (Out) consists of cash and property transfers.

NOTE 21 Disclosures Related to the Statement of Custodial Activity:

NOTE 22 Inter-Agency Eliminations
(\$ in Thousands)

Part A. DoD Eliminations of Seller Activity With Other Federal Agencies Arrayed by DoD Entities	Accounts Receivable With Other Federal Entities	Revenue With Other Federal Entities	Unearned Revenue From Other Federal Entities
Department of the Army, WCF	\$6,590	\$9,592	\$317
Total	<u>\$6,590</u>	<u>\$9,592</u>	<u>\$317</u>
Part B. DoD Eliminations of Seller Activity Arrayed by Other Federal Agencies	DoD Accounts Receivable Arrayed by Customer	DoD Revenue Arrayed by Customer	DoD Unearned Revenue by Customer
Executive Office of the President, Defense Security Assistance Agencies			
Department of Agriculture	58	93	
Department of Commerce	1	4	
Department of Interior	343	(42)	12
Department of Justice	645	503	
Department of Labor	38	42	
Department of State	18	63	
Department of the Treasury	141	542	
Office of Personnel Management			
Nuclear Regulatory Commission			
Department of Veterans Affairs			6
General Service Administration	2,610	3,510	296
National Science Foundation			
Federal Emergency Management Agency			
Environmental Protection Agency			
Department of Transportation	1,084	3,452	
Agency for International Development			
Small Business Administration			
Department of Health and Human Services	55	308	
National Aeronautics and Space Administration	12	89	
Department of Housing and Urban Development			
Department of Energy	41	44	(14)
Department of Education			
Social Security Administration			
Unidentifiable Federal Agency Entity	383	971	17
Miscellaneous Identifiable Federal Agencies Not Required to Prepare CFO Audited Financial Statements	1,161	13	
Total	<u>\$6,590</u>	<u>\$9,592</u>	<u>\$317</u>

SUPPORTING AUDIT REPORTS

Army Working Capital Fund Principal Financial Statements for Fiscal Year 1998, Report on Internal Controls and Compliance With Laws and Regulations

Army Working Capital Fund FY 98 Financial Statements, Fund Balance With Treasury

Army Working Capital Fund FY 98 Financial Statements, Statement of Budgetary Resources

Army Working Capital Fund FY 98 Financial Statements, Statement of Net Cost and Statement of Changes in Net Position

Army Working Capital Fund FY 98 Financial Statements, Inventory

Army Working Capital Fund FY 98 Financial Statements, Allowance for Unrealized Holding Gains and Losses

Army Working Capital Fund FY 98 Financial Statements, Property Plant and Equipment

Army Working Capital Fund FY 98 Financial Statements, Followup Issues

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Vice Chief of Staff
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Assistant Secretary of the Army (Financial Management and Comptroller)
Assistant Secretary of the Army (Installations, Logistics and Environment)
Assistant Secretary of the Army (Manpower and Reserve Affairs)
Assistant Secretary of the Army (Research, Development and Acquisition)
General Counsel
Director of the Army Staff
The Inspector General
Chief of Legislative Liaison
Chief of Public Affairs
Chairman, Army Reserve Forces Policy Committee
Deputy Chief of Staff for Logistics
Deputy Chief of Staff for Operations and Plans
Deputy Chief of Staff for Personnel
Assistant Chief of Staff for Installation Management
Commanders
 U.S. Army, Europe and Seventh Army
 U.S. Army Forces Command
 U.S. Army Training and Doctrine Command
 U.S. Army Materiel Command
 U.S. Army, Pacific
 U.S. Army Military District of Washington
 U.S. Army Corps of Engineers
 U.S. Army Criminal Investigation Command
 U.S. Army Aviation and Missile Command
 U.S. Army Communications-Electronics Command
 U.S. Army Industrial Operations Command
 U.S. Army Tank-automotive and Armaments Command
 U.S. Army Logistics Evaluation Agency
 3rd Military Police Group, U.S. Army Criminal Investigation Command
 6th Military Police Group, U.S. Army Criminal Investigation Command
 U.S. Army Materiel Command Logistics Support Activity
Directors
 Armament and Chemical Acquisition and Logistics Activity
 U.S. Army Center for Public Works
Commandant, U.S. Army Logistics Management College
Director, Center for Army Lessons Learned

Inspector General, Department of Defense

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Defense Finance and Accounting Service

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